SECURITIES AND EXCHANGE COMMISSION

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As filed with the Securities and Exchange Commission on August 3, 2001

File No. 70- 9671

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

AMENDMENT NO. 4
(First Post-Effective)
TO
FORM U-1 APPLICATION-DECLARATION
UNDER
THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Powergen plc
(and Subsidiaries Listed on Signature Page Hereto)
53 New Broad Street
London EC2M 1SL
United Kingdom
(Name of company filing this statement and address of
principal executive offices)

David Jackson
Company Secretary and
General Counsel
Powergen plc
53 New Broad Street
London EC2M 1JJ
United Kingdom

The Commission is requested to send copies of all
notices, orders and communications in connection with
this Application-Declaration to:

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Powergen plc, a public limited company formed under the laws of England and Wales ("Powergen"), and certain of its subsidiaries filed with the Securities and Exchange Commission (the "Commission") an Application-Declaration on Form U-1 on April 26, 2000, as amended on April 28, 2000, September 22, 2000 and December 6, 2000 (said Form U-1 as so amended is referred to herein as the "Original Form U-1"). Capitalized terms used herein and not defined herein shall have the meanings assigned thereto in the Original Form U-1.

On December 6, 2000, the Commission issued an order with respect to the Original Form U-1 in Holding Co. Act Release No. 27291 (the "Order"). In the Order, the Commission reserved jurisdiction over, among other things, the implementation of a tax allocation agreement (the "Tax Allocation Agreement") and the formation and retention of LG&E Energy Settlements Inc. ("LG&E Settlements").

The purpose of this Amendment No. 4 (First Post-Effective) is to provide additional information regarding the proposed Tax Allocation Agreement and to withdraw the request regarding the formation of LG&E Settlements. In light of the additional information provided in this Amendment No. 4, the Applicants request that the Commission release jurisdiction over and approve the implementation of the Tax Allocation Agreement(1).

In support of this request, Powergen provides the following additional information which is added to Item 3.E. of the Original Form U-1. In addition, Exhibits C-3.1 and C-3.2 to the Original Form U-1 are amended and replaced by Exhibits C-3.l and C-3.2 hereto.

Since the date of Original Form U-1, the application of the new tax law in the UK has in some respects been clarified. As a result of that clarification, it is no longer advantageous to form a separate corporation to act as a tax clearing company. Thus, Applicants withdraw the request for the formation and retention of LG&E Settlements. Rather, Applicants propose that the tax clearing function will be performed by LG&E Energy.

Applicants request that the Commission approve an agreement for the allocation of consolidated tax among Powergen USA, Powergen US Investments Corp., and the LG&E Energy Group. Rule 45(c)(5) requires that associate companies with a positive allocation will pay the amount allocated and those subsidiary companies with a negative allocation will receive current payment of their corporate tax credits. The Tax Allocation Agreement does provide for each associate company to pay its separate tax liability and for each subsidiary company with a negative allocation to receive current payment of its corporate tax benefits. At issue is the treatment of the corporate tax benefits attributable to Powergen USA.

Pursuant to Section 4 of the Tax Allocation Agreement, each member of the affiliated group shall pay the amount of its separate return tax to LG&E Energy. LG&E Energy shall pay each member with a corporate tax credit, the amount of such credit, except that any corporate tax

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(1) In Holding Co. Act Release No. 27231, notice was given that in the Original Form U-1 the Applicants requested approval for a tax allocation agreement among Powergen USA (formerly, Powergen US Partnership), Powergen US Investments Corp. and the LG&E Energy Group which provided for the retention by the Powergen entities within the consolidated group of certain payments for tax losses, rather than the allocation of the losses to subsidiary companies without payment, as would otherwise be required by Rule 45(c)(5) under the Act.

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credit attributable to Powergen USA associated with its acquisition-related debt(2) shall be retained at LG&E Energy. To the extent that the aggregate separate tax return liability of the members exceeds the consolidated tax liability of the affiliated group, the excess shall be allocated to the members having separate tax liability in proportion to the separate tax liabilities of such members. In addition, tax benefits of Powergen USA not attributable to acquisition-related debt (if any) will be allocated to members having a separate return tax liability in proportion to the separate return tax liabilities of those members.

From a legal perspective, this approach is no different than the tax allocation agreement approved by the Commission in The National Grid Group plc, Holding Company Act Release No. 27154 (March 15, 2000) (the "Grid Order"). In the Grid Order, the Commission approved a tax allocation agreement that does not require the holding company to allocate its tax benefits associated with acquisition-related debt to its subsidiary companies. This deviation from Rule 45(c) was specifically authorized by the Commission in the Grid Order. Similar to the tax allocation agreement approved in the Grid Order, the proposed Tax Allocation Agreement does not require allocation to the subsidiary companies of the tax benefits of Powergen USA associated with acquisition-related debt.

The tax allocation agreement approved in the Grid Order provided that amounts attributable to the tax benefits associated with acquisition-related debt could be paid to the holding company, National Grid General Partnership ("NGGP"). As described above, the Applicants do not seek authority to transfer to Powergen USA amounts attributable to corporate tax benefits of Powergen USA associated with its acquisition-related debt, but rather request authority to retain such amounts in LG&E Energy. The Applicants propose that such amounts retained at LG&E Energy would be made available to the companies within the LG&E Energy Group, in order to promote the businesses of LG&E and KU and the other energy-related companies within the LG&E Energy Group. This structure is decidedly more advantageous to the LG&E Energy Group than the tax allocation agreement approved in the Grid Order.

The Applicants request a deviation, albeit a deviation advantageous to the LG&E Energy Group, from the structure approved by the Commission in the Grid Order in order to obtain a more economically efficient structure. By retaining Powergen USA's tax benefits at LG&E Energy and making them available to the LG&E Energy Group, the external debt within the LG&E Energy Group can be significantly reduced. Also, as tax is charged in Luxembourg on amounts paid to Powergen USA, the retention of Powergen USA's tax benefits in LG&E Energy results in more funds being available to reduce the overall debt levels of the US Subsidiary Companies (including the LG&E Energy Group).

For purposes of example(3), it is assumed that Powergen USA's tax benefit associated with the acquisition-related debt is $73,500,000 -- i.e., U.S. tax at an assumed rate of 35% in respect of interest expense at an assumed rate of 7% per annum on $3 billion of loan notes. If Powergen

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(2) For purposes hereof, "acquisition-related debt" shall mean the debt of Powergen USA incurred from time to time to finance the acquisition of its U.S. utility and energy-related businesses, including LG&E Energy, and any debt incurred to refinance or refund the foregoing.

(3) This example is presented in greater detail in Attachment I hereto.

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USA were compensated for this corporate tax credit resulting from the interest payments, Powergen USA would receive a payment of $73,500,000 each year. The tax payable in Luxembourg on this payment at a 37% tax rate would be $27,195,000. There is no tax credit available to offset this tax liability in Luxembourg. Thus, this tax liability would be an incremental cost to the Powergen system. The after-tax amounts, $46,305,000, could then be applied by Powergen USA to make loans, directly or indirectly, to LG&E Energy Corp. and its subsidiaries. However, the LG&E Energy Subsidiary Companies would be required to borrow in the first year an additional $27,195,000 externally, in order to match the aggregate funding of $73,500,000 available to the LG&E Energy Group if the proposed Tax Allocation Agreement is approved. Additional debt requirements in subsequent years would be even greater. In addition, if these monies are loaned to the LG&E Energy Subsidiary Companies, interest received by Powergen USA on any such loan would also be subject to tax in Luxembourg at the 37% tax rate. For example, if the $46,305,000 were loaned at an interest rate of 7% per annum, additional taxes of $1,199,300 would be payable -- thus, further reducing the amount available internally to fund the businesses of the LG&E Energy Group companies.

Alternatively, the amounts paid to Powergen USA in respect of its corporate tax benefit could be used to reduce Powergen USA's loan notes outstanding to its parent company or be paid to its parent company as dividends.(4) If such amounts are paid up the chain of Intermediate Companies to US Holdings, US Holdings could presumably apply such amounts to reduce its acquisition-related debt by $46,305,000. However, in this example, the LG&E Energy Subsidiary Companies would be required to borrow externally $73,500,000 in order to replace the funds that would otherwise be available to the LG&E Energy Subsidiary Companies under the proposed Tax Allocation Agreement. Thus, in the first year the Powergen System would have increased its aggregate debt outstanding by $27,195,000, with an additional interest expense of approximately $1,903,650, assuming a 7% per annum interest rate.

In addition, as a result of a recent change in UK tax law, there may be adverse tax consequences in the UK if the corporate tax benefits attributable to the acquisition-related debt were to be allocated to the subsidiary companies. The treatment of such allocation under the UK tax law is not certain at this time and may not be determinable unless and until the taxing authorities are presented with the issue, and respond to a specific factual situation. This could take two or three years.

Furthermore, pursuant to an order of the Kentucky Commission issued in connection with the formation of LG&E Energy Corp. in 1991, each of LG&E and KU pays/receives tax liabilities/benefits on a stand-alone basis in accordance with corporate guidelines and policies on inter-company transactions. The Kentucky Commission has not imposed any requirement that tax benefits at the parent company or any of its non-utility subsidiaries be shared with the utility subsidiaries. The treatment of the U.S. Utility Subsidiaries under the proposed Tax Allocation Agreement is consistent with existing practice, approved by the Kentucky Commission.

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(4) The capital structure of Powergen USA was structured to be economically efficient based upon existing tax and accounting considerations. Any repatriation of funds to US Holdings would need to be handled in a manner so as not to disadvantage this structure.

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In addition, since the LG&E Energy Group Companies have no obligation with respect to the acquisition-related debt and such debt does not affect the LG&E Energy Group's financial position, it is not inappropriate to exclude these companies from the direct benefits of the tax consequences resulting from such debt.(5)

It is presently intended that amounts retained by LG&E Energy will be reinvested in the LG&E Energy Subsidiary Companies. Based upon current forecasts, it is anticipated that in the foreseeable future any amounts retained by LG&E Energy will be required to fund cash needs of the LG&E Energy Subsidiary Companies. LG&E Energy may make such funds available to LG&E Energy Subsidiary

Companies through capital contributions, loans through the money pool or inter-company loans.(6) In this regard, the Applicants will commit that LG&E Energy will make such funds available only to, or for investment in, LG&E, KU, energy-related companies, as defined in Rule 58 (each, a "Rule 58 Subsidiary"), EWGs (other than foreign EWGs) and LG&E Energy Intermediate Subsidiaries authorized by the Order to acquire, hold and/or finance the acquisition of the securities of or other interests in such Rule 58 Subsidiaries and/or domestic EWGs.

To the extent that amounts retained at LG&E Energy are not reinvested in the LG&E Energy Subsidiary Companies, the Applicants would expect such amounts to be paid to Powergen USA and up the chain of Intermediate Companies through dividends (to the extent permitted under the Act), interest payments and repayment of principal.

The Applicants' proposed application of the corporate tax benefit associated with the acquisition-related debt is consistent with that of The National Grid Group plc. In the Application-Declaration in File No. 70-9519, The National Grid Group plc states that the funds retained by NGGP will, to the extent not reinvested in NEES or another business, flow up the chain of intermediate companies to The National Grid Group plc through dividends, interest payments, share repurchases and the repayment of principal.

Approval of the proposed Tax Allocation Agreement will not be detrimental to consumers, investors or the public interest, nor will it lead to the abuses that Section 12 is intended to prevent. Furthermore, there are various safeguards in place to insure that the proposed structure cannot be used to the detriment of investors, consumers or the public interest.

The Tax Allocation Agreement provides that under no circumstance shall the amount of tax allocated to a member exceed its separate tax liability. Further, as described above, pursuant to an order of the Kentucky Commission, each of LG&E and KU must pay/receive tax

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(5) See Paragraph III.B.3. of the Grid Order.

(6) Interest on any inter-company loans to LG&E or KU would bear interest at a rate, determined monthly, equal to the greater of (i) the weighted average rate of return on short-term investments of LG&E and KU outstanding on the last day of the prior month or, if no short-term investments are outstanding, the previous month's rate of return earned by the Financial Square Fund managed by Goldman Sachs & Co. or (ii) the weighted average rate of any commercial paper issued by LG&E and KU outstanding on the last day of the prior month or, if no such commercial paper is outstanding, the commercial paper rates of similarly rated companies for the prior week as published in the Federal Reserve Statistical Release H.15. The terms and conditions of inter-company loans to Non-Utility Subsidiaries will be materially no less favorable than the terms and conditions of loans available to the borrowing company from third-party lenders.

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liabilities/benefits on a stand-alone basis. Thus, the obligations of the U.S. Utility Subsidiaries under the proposed Tax Allocation Agreement is consistent with existing practice, approved by the Kentucky Commission.

In addition, pursuant to the Order, the Applicants commit, as a general term and condition of issuance of securities authorized by the Order, to maintain the common stock equity of each of LG&E and KU, individually, at not less than 35% of total capitalization and to maintain the common stock equity of LG&E Energy at not less than 30% of total capitalization.

Furthermore, as described in the Original Form U-1, pursuant to the order of the Kentucky Commission authorizing the transfer of ownership of LG&E and KU through the acquisition of ownership and control of LG&E Energy Corp. by Powergen (the "Kentucky Order"), the dividend policies of LG&E and KU remain under the jurisdiction of the Kentucky Commission. Specifically, the Kentucky Commission reiterated its position that "the dividend policy [of KU and LG&E] must not adversely affect the utilities' ratepayers, and the utilities, through their boards of directors, have the responsibility to use their dividend policy consistent with preserving the financial strength of the utility." As part of the proceeding before the Kentucky Commission, and as a condition to the effectiveness of the Kentucky Order, Powergen has committed to notify the Kentucky Commission 30 days prior to paying any dividend or transferring more than 5 percent of the retained earnings of LG&E or KU to Powergen.

The Tax Allocation Agreement does not provide a means by which the holding companies can "milk" the U.S. Utility Subsidiaries. Rather, the Tax Allocation Agreement contains only such deviations from Rule 45(c) as are necessary and appropriate to address the unique circumstances of a system with a foreign holding company. Such deviations do not undermine the purposes of Section 12 nor will they be detrimental to investors, consumers or the public interest.

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SIGNATURE

Pursuant to the requirements of the Public Utility Holding Company Act of 1935, the Applicants have duly caused this amendment to Application/Declaration to be signed on their behalf by the undersigned duly authorized.

Date: August 3, 2001

Powergen plc
Powergen USA
Powergen US Investments Corp.

LG&E Energy Corp.
Louisville Gas and Electric Company
Kentucky Utilities Company
LG&E Capital Corp.
LG&E Energy Marketing Inc.

By: Powergen plc

By: /s/ Peter Hickson

Peter Hickson
Executive Director Finance

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EXHIBIT INDEX

C-3.1 Tax Allocation Agreement (Revised)

C-3.2 Legal Analysis of Rule 45(c) and the Proposed
Tax Allocation Agreement

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EXHIBIT C - 3.1
(REVISED)

TAX ALLOCATION AGREEMENT

Agreement dated __________, 2001, by and among Powergen USA and its undersigned subsidiaries.

WITNESSETH

WHEREAS, the parties hereto are members of an affiliated group ("Affiliated Group") as defined in Section 1504(a) of the Internal Revenue Code of 1986, as amended ("Code"), of which Powergen USA is the common parent; and

WHEREAS, such Affiliated Group will file a U.S. consolidated income tax return for its tax period 2000 (to be filed by September 15, 2001) and is required to file consolidated tax returns for subsequent years; and

WHEREAS, Louisville Gas & Electric Company ("LG&E") was ordered in the Commonwealth of Kentucky Public Service Commission Case No. 89-374 to allocate income tax liabilities using the "stand alone" method; and

WHEREAS, Kentucky Utilities Company ("KU") was ordered in the Commonwealth of Kentucky Public Service Commission Case No. 10296 to develop, implement, and maintain cost allocation procedures that will prevent cross-subsidization; and

WHEREAS, it is the intent and desire of the parties hereto that a method be established for allocating the consolidated tax liability of the Affiliated Group among its members, for reimbursing LG&E Energy Corp. ("LG&E Energy") for payment of such tax liability, for compensating any party for use of its losses or tax credits, and to provide for the allocation and payment of any refund or credit arising from a carryback, or carryforward of losses or tax credits from other tax years.

NOW, THEREFORE, in consideration of the mutual covenants and promises contained herein, the parties hereto agree as follows:

1. Definitions:

"Consolidated tax" shall mean the aggregate tax liability for a taxable year, being the tax shown on the consolidated return of the Affiliated Group and any adjustments thereto thereafter determined. The consolidated tax shall mean the amount of the refund if the consolidated tax return shows a negative tax liability.

"Corporate taxable income" shall mean the income or loss of a member, computed as though such company had filed a separate return on the same basis as used in the consolidated return, except that dividend income from associate companies shall be

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disregarded, and other intercompany transactions eliminated in the consolidated return shall be given appropriate effect. Carryovers and carrybacks shall not be taken into account to the extent that the member has been paid a corporate tax credit therefor under paragraph 4 of this Agreement.

"Corporate tax credit" shall mean the negative separate return tax of a member for a taxable year, equal to the amount by which the consolidated tax is reduced by including a net corporate taxable loss or other tax benefit of such associate company in the consolidated return.

"Holding Company" means LG&E Energy and each member of the Affiliate Group which is a parent company of LG&E Energy.

"Powergen Holding Company" means each Holding Company other than LG&E Energy.

"Separate return tax" shall mean the tax on the corporate taxable income of a member computed as though the member were not a member of a consolidated group.

2. A U.S. consolidated income tax return shall be filed by Powergen USA for the tax period ended December 31, 2000 and for each subsequent taxable period in respect of which this Agreement is in effect and for which the Affiliated Group is required or permitted to file a consolidated tax return. Powergen USA shall be solely responsible for the preparation of such returns, and shall be entitled to make all such elections under the Code (in its sole discretion) as it shall deem appropriate or advisable in connection with those returns; provided that Powergen USA shall have no liability to the subsidiaries for any errors or omissions in the preparation or filing of those returns, or in connection with those elections. Each of the undersigned members shall, and shall cause their respective subsidiaries to execute and file such consents, elections, and other documents that Powergen USA may in its sole discretion determine are required or appropriate, in Powergen USA's discretion and at its request, for the proper filing of, or in connection with, such returns, and take all such other actions as shall be required to give effect to the provisions of this Agreement. The undersigned members and their respective subsidiaries are hereinafter collectively referred to as the "subsidiaries" or "members", and individually referred to as a "subsidiary" or a "member".

3. LG&E Energy will make all Federal corporate income tax payments to the Internal Revenue Service on behalf of the Affiliated Group.

4. Each member (including each Holding Company) shall pay the amount of its separate return tax to LG&E Energy if such amount is positive. LG&E Energy

shall pay any member with a positive corporate tax credit the amount of such credit; provided, however, that no such payment shall be made in this respect to any Holding Company. Any corporate tax credit of a Holding Company, other than in connection with tax benefits related to the debt incurred by Powergen USA (or any other Powergen Holding Company) from time to time to finance the acquisition of its U.S. utility and energy-related businesses, including LG&E Energy and its direct and indirect subsidiaries, and any debt incurred to refinance or refund the foregoing ("Acquisition Debt"), shall be

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reallocated to the other members of the Affiliated Group having a positive separate return tax liability in proportion to their separate return tax. The corporate tax benefits related to the Acquisition Debt shall be retained by LG&E Energy. In the event that the total separate return tax of the Affiliated Group exceeds the consolidated tax liability of the Affiliated Group, the excess shall be allocated to the members having positive separate return tax liability in proportion to the separate return tax liabilities of such members. For purposes of this Agreement, any liability for alternative minimum tax shall be treated as part of the member's separate tax liability provided that the entire Affiliated Group incurs an alternative minimum tax liability. Intercompany eliminations recorded by consolidation entries that affect the consolidated tax will be assigned to the appropriate member necessitating the intercompany elimination for the purpose of computing separate return tax. In the event that less than all of the net tax benefits of the members having negative separate return tax are absorbed, the aggregate corporate tax credit applicable to such members shall be allocated to such members in proportion to their separate return tax liabilities; provided, however, that to the extent that the consolidated tax and separate return tax for any year include material items taxed at different rates or involve other special benefits or limitations, the associated tax benefits shall be first allocated, to the extent possible, to the individual members of the group applicable to them. Under no circumstances shall the amount of tax liability allocated to a member of the Affiliated Group under this Agreement exceed its separate tax liability.

5. Payment of the consolidated U.S. tax liability for a taxable period shall include the payment of estimated tax installments due for such taxable period. Each member shall pay to LG&E Energy an amount equal to its positive separate return tax liability, if any, for that taxable period, and LG&E Energy shall pay to each member an amount equal to its corporate tax credit attributable to that taxable period, in each case by the due date for payment of the consolidated U.S. taxes. Any amounts paid by a member on account of a separate return or separate estimated tax payment that are credited against the consolidated tax liability of the Affiliated Group shall be included in determining the payments due from such member. Any overpayment of estimated tax shall be promptly refunded to such member.

Payment shall be made within ten days after each quarterly payment date for estimated taxes and the date of filing of the consolidated return for such taxable period.

6. If part or all of an unused loss or tax credit is allocated to a member of the Affiliated Group pursuant to Treasury Regulations Section 1.1502-79, and is carried back or forward to a year in which such member filed a separate return or a consolidated return with another affiliated group, any refund or reduction in tax liability arising from the carryback or carryover shall be retained by such member. Notwithstanding the above, Powergen USA shall determine whether an election shall be made not to carry back part or all of a consolidated net operating loss for any tax year in accordance with Section 172(b)(3) of the Code.

7. If the consolidated tax liability is adjusted for any taxable period, whether by means of an amended return, claim for refund, or after a tax audit by the Internal Revenue Service, the liability of each member shall be recomputed to give effect to such adjustments, and in the case of a refund, LG&E Energy shall make payment to each member for its share of

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the refund, determined in the same manner as in paragraph 4 above, within ten days after the refund is received by LG&E Energy, and in the case of an increase in tax liability, each member shall pay to LG&E Energy its allocable share of such increased tax liability, penalties and interest within ten days after receiving notice of such liability from LG&E Energy.

8. The allocation of state and local income tax liabilities will be determined based on the application of one of the following filing methods:

(1) Separate entity
(2) Unitary group
(3) Nexus Combined
(4) Consolidated (mirrors the federal group);

provided, however, that no member's state or local tax income tax liability under the Agreement shall exceed its state or local tax liability had it filed a separate return.

All tax cost or benefit determined under a SEPARATE ENTITY filing will be allocated to the subsidiary that filed the separate return.

Tax cost or benefit determined for a UNITARY filing will be allocated to the applicable business unit, similar to a separate entity filing allocation. For example, if the gas facilities group files a state unitary return including the gas facilities parent and all its subsidiaries, the entire state tax cost or benefit is allocated to the gas facilities group. Further allocation within the group is optional at the discretion of the group.

Tax cost or benefit determined for a NEXUS COMBINED filing will be allocated as if each entity or business unit (e.g., KU, LG&E, Power Generation, Facilities) filed a "stand alone" or separate entity return. Both apportionment factors and taxable income are to be considered in the allocation. No benefit will be allocated to Powergen USA. Any remaining cost or benefit will be allocated to LG&E Energy on at least an annual basis.

Tax cost or benefit determined for a CONSOLIDATED filing will be allocated based on each subsidiary's or business unit's nexus (as defined below) with the individual state or locality. For example, state tax determined in a consolidated return will be allocated as if the entity (or business unit) filed a "stand alone" or separate tax return using both: (a) the entity's (or business unit's) property, payroll, and receipts apportioned to the state and (b) their taxable income or loss. No tax cost or benefit will be allocated to any entity or business unit having no nexus in the state or locality, and no benefit will be allocated to Powergen USA. The remaining cost or benefit will be allocated to LG&E Energy on at least an annual basis.

For purposes of state and local allocations, the following definitions are provided:

"Nexus"--The connection an entity has with a taxing jurisdiction generally represented by property and payroll. The applicable jurisdiction's nexus standards will determine whether tax cost or benefit is allocated to an entity. (E.g., state sales or receipts of an

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entity may require inclusion in a consolidated return even though the entity itself does not have nexus and is protected by PL 86-272.)

"Unitary"--The relationship between related/affiliated members generally within a consolidated group. The applicable jurisdiction will determine whether the entities are unitary. This often requires a presence of unity of ownership (e.g., over 50% owned by common parent), unity of operation (back-office or central support functions) and unity of use (centralized policies, common management forces, intercompany products flow or services provided by one entity to another)

"Nexus-combined"--A return that includes only those entities having nexus in the applicable jurisdiction.

9. The payment or refund of any tax liability discussed in paragraphs 2-8 above may be satisfied through the debiting or crediting of the member's (s') intercompany payable or receivable account on the same day as payment

or refunds would have otherwise been required. If during a consolidated return period Powergen USA or any subsidiary acquires or organizes another corporation that is required to be included in the consolidated return, then such corporation shall join in and be bound by this Agreement.

10. This Agreement shall apply to the tax period ending December 31, 2000, and all subsequent taxable periods unless and until (a) this Agreement is terminated by the mutual consent of the signatories hereto, or (b) this Agreement is terminated by Powergen USA (in its sole discretion) as to any one or more subsidiaries at any time that those subsidiaries are no longer members of an affiliated group with Powergen USA under Section 1504(a) of the Code. Notwithstanding such termination, this Agreement shall continue in effect with respect to any payment or refunds due for all taxable periods ending on or prior to termination.

11. This Agreement shall be binding upon and inure to the benefit of any successor of the parties and their subsidiaries, whether by operation of law or otherwise, to the same extent as if the successor had been an original party to the Agreement.

12. This Agreement is subject to revision as a result of changes in income tax law and changes in relevant facts and circumstances, subject to approval of such revision by the Securities and Exchange Commission as and to the extent required by the Public Utility Holding Company Act of 1935.

13. Notwithstanding any provision in this Agreement to the contrary, income tax shall be allocated among the parties in a manner consistent with Rule 45(c)(2)(ii) of the Public Utility Holding Company Act of 1935.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed by their duly authorized representatives on _______________, 2001.

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Powergen USA

By

PowerGen US Investments Corp.

By

LG&E Energy Corp.

By

Louisville Gas and Electric Company

By

Kentucky Utilities Company

By

LG&E Capital Corp.

By

LG&E Energy Marketing Inc.

By

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EXHIBIT C-3.2
(REVISED)

LEGAL ANALYSIS OF RULE 45(C) AND THE PROPOSED TAX ALLOCATION AGREEMENT

INTRODUCTION AND SUMMARY

The Applicants(1) are seeking approval of a tax allocation agreement ("Agreement") that is intended to minimize the economic inefficiency to Powergen as a result of: (1) the potential U.K. tax liability; and (2) the Luxembourg tax liability that would be assessed on the corporate tax credits related to the debt incurred to acquire LG&E Energy and its subsidiaries. While the Agreement does not appear to come within the safe harbor of Rule 45(c) under the '35 Act, it nonetheless complies with the statutory requirements of the '35 Act and, so, should be approved under Section 12(b) of the '35 Act and Rule 45(a). The basis for this view is explained in more detail below, together with an analysis of the background to Rule 45(c).

KEY TO OUR ANALYSIS ARE THE FOLLOWING TWO POINTS:

(a) No entity will pay more tax under the Agreement than it would on a stand alone basis; and

(b) The Agreement relates only to the U.S. entities in the Powergen/LG&E Energy holding company system. It does not include any non-U.S. entity. Any dividends from the U.S. entities to non-U.S. parent companies will be subject to the requirements of Section 12(c) and Rule 46. Consequently, the Agreement does not provide the means for a foreign parent to "milk" the U.S. entities.

Rule 45(c) is intended to facilitate the sharing of consolidated tax return benefits while, at the same time, ensuring that the benefits are not misallocated to the detriment of utility subsidiaries and consumers. The rule is not intended to address all possible situations. Rather, it provides a safe harbor for certain types of sharing arrangements. In the fashion of a safe-harbor rule, it applies a cautious and narrow approach to achieve its purpose and excludes holding companies or their assignees from retaining the benefit of losses attributable to holding company operations unrelated to the business of the subsidiary companies.

The Agreement provides that LG&E Energy(2) will retain the benefit arising from the tax losses of Powergen USA so long as the "separate return limitation" is observed; that is, no other entity in the consolidated group pays more under the Agreement than it would have paid on a stand-alone basis. Section 4 of the Agreement provides that each member of the affiliated group shall pay the amount of its separate return tax to LG&E Energy. The Agreement further

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(1) Unless otherwise noted herein, the terms in this Exhibit C-3.2 have the same meaning as used in File No. 70-9761, as amended.

(2) As explained in the Form U-1 and the Agreement, it is proposed that

LG&E Energy serve as the tax clearing house for the Powergen USA and its subsidiary companies, including all of the subsidiary companies in the LG&E Energy Group.

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provides that LG&E Energy shall pay each member with a corporate tax credit the amount of such credit, except that any corporate tax credit attributable to Powergen USA associated with its acquisition-related debt(3) shall be retained at LG&E Energy. To the extent that the aggregate separate tax return liability of the members exceeds the consolidated tax liability of the affiliated group (excluding Powergen USA), the excess shall be allocated to the members having separate tax liability in proportion to the separate tax liabilities of such members. In addition, tax benefits of Powergen USA not attributable to acquisition-related debt (if any) will also be allocated to members having a separate return tax liability in proportion to the separate return tax liabilities of those members.

It is our view, consistent with the policies and provisions of the '35 Act, that a holding company or its assignee (i.e., LG&E Energy) should be permitted under the '35 Act to retain the benefit of losses that the holding company incurs in circumstances where there is no detriment to the subsidiaries or consumers. The losses at issue in this matter flow from interest payments on debt incurred, among other reasons, to acquire the equity of LG&E Energy, and not from subsidiary company activities. Consequently, the tax benefit of the losses should properly be allocated to the holding company incurring interest on the debt, or its assignee.

In pertinent part, Rule 45(c) governs the reallocation of tax benefits to subsidiary companies. Once the Commission makes the determination, as it did for The National Grid Group plc(4), that it is appropriate for a holding company not to reallocate certain tax benefits to its subsidiaries, Rule 45(c) may not be reasserted for purposes of determining where these benefits should be held.

TAX ALLOCATION AGREEMENTS, GENERALLY

Companies in a related corporate group often file consolidated tax returns that combine the income, tax credits, and losses of the group members on one consolidated return. Consolidation has the advantage of offsetting the taxable income of some companies in the group with the losses or tax credits of other group companies. The offsetting allows the consolidated group to pay less tax currently than if each company in the group filed separate tax returns.

Companies that participate in the filing of a consolidated tax return may agree to share the consolidated tax liability and any tax savings in various ways. The benefit to an individual company associated with filing on a consolidated basis is generally measured by comparison to the tax that the company would have paid if it had filed a separate, unconsolidated tax return. The following example illustrates how a simple consolidated return might work and the allocation of tax benefits and liabilities. The example also illustrates that each of the participating companies brings its unique tax attributes to the consolidation, such as investment tax credits, losses carried forward from prior years, and current income or losses.

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(3) The term "acquisition-related debt" means the debt of Powergen USA incurred from time to time to finance the acquisition of its U.S. utility and

energy-related businesses, including LG&E Energy, and any debt incurred to refinance or refund the foregoing.

(4) See Holding Co. Act Release No. 27154 (March 15, 2000).

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<Table>
<Caption>

<S>	Subsidiary A <C>	Subsidiary B <C>	Holding Co. C <C>	Consolidated <C>
Revenues	400	800	200	1400
Expenses	200	300	400	900
Income	200	500	-200	500
Loss Carryforward	0	0	-300	-300
Net Taxable Income	200	500	0	200
Tax (40%)	80	200	0	80
Tax Credit	0	100	0	80
Net Tax	80	100	0	0

</Table>

The columns for companies A, B and C illustrate the tax calculations on an unconsolidated, separate basis for each company. The consolidated column shows how the individual tax attributes of each company are combined in the consolidated return. For example, adding across columns the income of A and B, and the $200 current year loss of C, produces consolidated income of $500. Moving to the next row we note that C also had accumulated losses of $300 from prior years which reduce the consolidated net taxable income to $200. Applying a hypothetical 40% tax rate to the consolidated net taxable income results in a consolidated tax of $80, before credits. We apply $80 of the $100 tax credit held by B to the consolidated tax to produce a net tax of $0. The remaining $20 of credit goes unused, on a consolidated basis, and is carried forward to future years.

On a separate return basis, A and B would have tax before credits of $80 and $200, respectively on their separate incomes. C would pay no tax on a separate return basis because it has no net taxable income. On a separate return basis B can use all of its $100 tax credit to offset part of its $200 tax, with the result that it would owe net tax of $100.

The tax savings realized from consolidation is $180; the difference between the aggregate tax payable by A, B, and C, on a separate return basis ($80, $100, and $0, respectively) and the tax payable on a consolidated basis ($0). The consolidated group saves by using holding company C's losses, and $80 of the $100 tax credit held by B, on the consolidated return. The tax savings may be allocated in many ways. An equitable allocation method might take into consideration that C has surrendered the ability it would have had to accumulate and use its losses against income that it may earn in future years, if it had filed a separate tax return. The allocation method also might recognize that the consolidated group has retained $20 of unused tax credits. Lastly, the allocation method may require that no company be worse off than it would have been had it filed a separate tax return.

Based on these considerations, it would not be unreasonable for A and B to pay $80 and $100, respectively, to C and, in addition, for C to receive the entitlement to the $20 unused tax credit. C would receive aggregate value of $200; the equivalent of the tax benefit that it provided to the consolidated group by contributing its losses ($500 x 40% = $200). A and B are no worse off by participating in the consolidated return and the system, as a whole, is $180 better off.

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THE COMMISSION'S REGULATION OF TAX ALLOCATION AGREEMENTS

The commingling of tax attributes and the allocation of tax liabilities and benefits under a consolidated return are intrasystem transactions regulated under Section 12 of the '35 Act. Section 12(b) prohibits a registered holding company or subsidiary company from lending to, extending its credit to, or indemnifying any company in the same holding company system in violation of such rules, regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors and consumers. Rule 45(a) prohibits a registered holding company or subsidiary company from lending, extending its credit to, indemnifying, or making a donation or capital contribution to, any company in the same holding company system, except pursuant to a declaration filed with the Commission.

A declaration is not required, however, for the filing of a consolidated tax return by companies in a holding company system if the consolidated return is filed under a tax allocation agreement that provides for the allocation of liabilities and benefits arising from the consolidated return for each tax year in a manner not inconsistent with the provisions of Rule 45(c). The rule has one fundamental requirement: that the consolidated tax apportioned to any subsidiary shall not exceed the tax that the company would have paid computed as though it were not a member of the consolidated group (the "separate return limitation"). Rule 45(c) provides that a tax allocation agreement can either pay companies with losses currently for the use of the losses on the consolidated return or the tax allocation agreement can exclude loss companies from a current allocation of the benefit of their losses provided that the tax allocation agreement gives the loss companies carryover rights that can be used to reduce their consolidated tax allocation in future years.(5) The latter provision, providing for future compensation to the associate company for the current use of losses or credits by the consolidated group, addresses the circumstances that are most likely to have the potential for abuse and, from a policy perspective, is closest to the intrasystem loans and extensions of credit that Section 12 was intended to address.

Rule 45(c)(5) also contains one additional interesting feature. To comply with the rule, a tax allocation agreement should provide that associate companies with a positive allocation will pay the amount allocated, but only those subsidiary companies with a negative allocation, i.e., the loss companies, receive current payment or carryover rights for their losses or credits. Because the term "associate company" includes a holding company, but we understand the term "subsidiary company" to exclude a holding company, Rule 45(c) has the effect of requiring holding companies to pay their share of the consolidated tax liability, but excludes them from sharing in the tax benefits of any losses they may have generated on a stand-alone basis.(6) In the example shown above, an allocation agreement in compliance with Rule 45(c) would allocate $0 tax liability to subsidiaries A and B, allow B to retain the unused $20 of tax credits, and allocate $0 to holding company C for the use of its losses on the consolidated return. In effect, Rule 45(c) requires C to contribute an aggregate of $200, the value of its losses, to A and B.

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(5) Rule 45(c)(4).

(6) Holding Company Act Release No. 21767 (Oct. 29, 1980) ("Rule 45(c) Proposing Release").

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POWERGEN' S PROPOSAL

The proposed Agreement (Exhibit C-3.l) provides for the retention by LG&E Energy of certain payments for tax losses that have been incurred by Powergen USA, a U.S. subsidiary of Powergen and the holding company parent of LG&E Energy--rather than the allocation of the tax benefits of such losses to Powergen USA's subsidiary companies without payment, as would otherwise be required by Rule 45(c). Powergen USA's tax losses will come principally from interest expenses incurred to finance the acquisition of LG&E Energy.(7)

As a general matter, registered holding companies that incur debt loan it to subsidiaries on mirror image terms. These holding companies, therefore, do not generate significant interest-related losses because they receive offsetting interest income from the borrowing subsidiaries. Powergen USA, however, is using its debt proceeds to purchase LG&E Energy's equity and, consequently, Powergen USA will not earn offsetting interest income. The Powergen USA financing costs will not have been incurred by the regulated subsidiaries to acquire or operate their businesses. Nor will the borrowings be guaranteed by the utility companies. Accordingly, the providers of the finance will not have recourse to the assets of the regulated subsidiaries.

As with other expenses, the tax relief for the interest is a consequence of the borrowing and it is not a benefit per se. As noted below in the discussion of the background to Rule 45(c), it is not detrimental to the subsidiaries or consumers if the holding company or its assignee retains the tax benefit of losses that the holding company incurs from activities that are unrelated to subsidiary operations and not properly chargeable to the subsidiaries. For example, Powergen USA may not properly pass through to the subsidiary companies legal expenses due to a corporate reorganization unrelated to subsidiary operations. For the same reason, as a matter of equity, Powergen USA also should be able to assign to LG&E Energy the tax benefit produced by the interest. Accordingly, it is both economically appropriate and equitable that Powergen USA should be able to assign to LG&E Energy current payment for its losses that are used on the consolidated return to offset the income of Powergen USA's subsidiaries.

Powergen's proposal is consistent with the policy of Section 12 of the '35 Act. The '35 Act does not prohibit holding companies or their assignees the benefit of the tax attributes that the holding companies generate, nor does it require holding companies to distribute all tax benefits to subsidiary companies. Section 12 merely requires that holding companies may not borrow from subsidiaries and that loans from the holding company to a subsidiary, or loans among subsidiaries, not violate rules adopted by the Commission for the protection of consumers, investors and the public interest.(8)

Rule 45(c) is a safe-harbor rule. Safe-harbor rules by their nature are intended to provide for typical situations and to exclude unique circumstances or close calls. Tax allocation agreements that fall outside the safe harbor should be permitted if they do not adversely affect

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(7) The Agreement provides that any tax benefits payable to Powergen USA which are not related to the acquisition-related debt will be allocated to LG&E Energy's subsidiaries.

(8) Sections 12(a) and 12(b).

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the protected interests under the '35 Act and are consistent with the policies underlying the '35 Act. Because Powergen's proposed Agreement may not fall within the safe harbor of Rule 45(c), Powergen seeks the Commission's authorization of the Agreement by order under Section 12 of the '35 Act and Rule 45(a).

ANALYSIS

Prior to the Adoption of Rule 45(c), the Commission Permitted Holding Companies to Share in the Tax Savings.

In 1941, the Commission adopted an amendment to Rule U-45 to exempt a loan, extension of credit and an agreement of indemnity arising out of a joint tax return filed by a holding company and its subsidiaries.(9) Rule U-45(b)(6) conditioned the exemption upon the assumption by the top company in the group of the primary responsibility for the payment of any tax liability involved, subject to the right to contribution of the several members of the group in an amount not exceeding as to any company that percentage of the total tax which the individual tax of such company (if paid under a separate return) would bear to the total amount of individual taxes for all members of the group, for the particular tax period. At its inception therefore, Rule U-45(b)(6) established the fundamental principle of the separate return limitation and did not restrict holding companies from retaining the benefit of any tax losses that they may have generated.

In 1955, in response to the Commission's directive to make further study of the subject of tax allocation, the staff proposed, and the Commission adopted, further amendments to Rule 45(b)(6).(10) The amendments required a tax allocation agreement to allocate the consolidated tax liability by either of two methods prescribed in the Internal Revenue Code. One method allocated the consolidated tax based on the proportion of taxable income attributable to each member and the other method allocated the consolidated tax based on the proportion of each member's separate return tax to the aggregate separate return tax of all the group members. The amendment also reaffirmed the principle that the allocations could not violate the separate return limit and, if excess tax would have been allocated to a subsidiary company but for the separate return limit, that the excess liability would be allocated among the other members of the group, including the holding company, in direct proportion to the tax savings of each member.

In 1981, Rule 45(b)(6) was revised for the last time and redesignated Rule 45(c).(11) This revision was meant to eliminate the numerous declarations and Commission orders which had been necessary because Rule 45(b)(6) did not adequately address the case in which one or more operating companies in the system suffers a loss. The allocation methods in Rule 45(b)(6) had been interpreted to require sharing of tax liabilities and savings exclusively among group companies with actual separate return tax liabilities or positive income. Consequently, loss companies had been excluded from receiving the benefit of their losses.

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(9) Holding Company Act Release No. 2902 (July 23, 1941).

(10) Holding Company Act Release No. 12776 (Jan. 12, 1955).

(11) Holding Company Act Release No. 21968 (Mar. 18, 1981) ("Rule 45(c) Adopting Release").

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The Rule 45(c) Proposing Release indicates that Rule 45(c) is intended to allow loss subsidiaries to receive the benefit of their losses, but that holding companies must give their loss-related tax benefits to their subsidiaries. With regard to subsidiary losses, the proposing release observes that oil and gas exploration subsidiaries often produced substantial losses, especially in the early years of operation, because large up-front development expenses were immediately deductible, while the income producing oil and gas production occurs significantly later.

On the subject of holding companies, however, the Commission's reasoning is less clear. As the Rule 45(c) Proposing Release explains, the exploitation of utility companies by holding companies through asserted misallocation of consolidated tax return benefits was among the abuses examined in the investigations underlying the '35 Act.(12) Then the release states:

> The corporate relationships required by the Act assure that the deductible corporate expenses of the holding company itself will always create a consolidated tax saving, since Section 13(a) of the Act precludes such expenses being passed on to the subsidiaries, through service charge or contract, so as to transform them into corporate deductions of the subsidiaries. In light of the legislative history referred to, an expense reimbursement of the holding company, in the guise of a tax allocation, would seem inconsistent with Section 13(a). The exclusion in our earlier rule of the holding company from sharing in consolidated return savings was intentional and will continue. These considerations do not apply to other companies in the group that incur losses.

Section 13 is fundamentally about fairness of allocation in service charges and other contracts. There is no violation of Section 13 where a holding company, which does not pass through its expenses to the subsidiary companies, retains the tax benefit flowing from the expenses for itself. As the example that began this discussion illustrates, subsidiaries A and B pay amounts equal to their separate return tax liabilities to the holding company and B gives up

$20 of tax credits that it also would have used on a separate return basis. C, the holding company, retains these payments instead of remitting them to the Internal Revenue Service ("IRS"). The IRS, in fact, is the entity that provides the partial reimbursement for the holding company's expenses through a reduction in taxes that the consolidated group otherwise would have paid. The subsidiaries, in this situation, are not reimbursing the holding company's expenses through their consolidated tax payments or otherwise. Indeed, the separate return limitation in Rule 45(c) and in the proposed Agreement ensures that an impermissible reimbursement does not occur. If, as Rule 45(c) provides, C must instead remit the IRS reimbursement to the subsidiaries, C is in effect required to make a capital contribution to them that is not otherwise required by the '35 Act and contrary to the separate return limitation that has been the fundamental allocation principle since Rule U-45(b)(6) was adopted.

In addition, the conclusion of the Rule 45(c) Proposing Release -- that holding companies should not retain (or, by implication, assign to another entity) the benefit of their tax losses -- does not follow from the legislative history that it cites. Rather, the legislative history argues for retaining to each subsidiary the benefits of its tax losses. Clearly, subsidiary losses should not be used to benefit the holding company that had not incurred the expense that gave rise to the loss.

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(12) Rule 45(c) Proposing Release (citing Senate Doc. 92, Part 72A, 70th Congress, 1st Sess., 1930 (pp. 477-482).

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To allocate the loss otherwise would be detrimental to ratepayers who benefit from the tax-reducing value of the loss through lower rates. It is not, however, detrimental to the subsidiaries or consumers if the holding company retains the tax benefit of losses that it incurs from activities that are unrelated to subsidiary operations and not properly chargeable to the subsidiaries. Rule 45(c)(3) reflects this principle by requiring that the allocations under an agreement provide for equitable adjustment of the material effects of any particular features of the tax law applicable to the individual members of the group, e.g., capital gains taxed at a different rate than ordinary income.(13)

For example, if a utility subsidiary earns investment tax credits from building a plant, its tax liability should reflect the benefit of the credits and its rates should also reflect the tax savings from the credits. Similarly, if the holding company incurs legal expenses from a corporate reorganization that may not properly be passed through to the subsidiary companies, the holding company should retain the tax benefit produced by the expenses. Rule 45(c) addresses Congress' concerns as expressed in the legislative history to the extent that it requires that tax benefits should track the entity that created them.(14) The complete exclusion of holding companies from receiving the benefit of their losses under the rule, however, does not accurately reflect the legislative history.

WHY POWERGEN MAY SUFFER AN INCREASED U.K. TAX LIABILITY WITHOUT THE PROPOSED AGREEMENT

As a U.K. company, Powergen must manage both U.K. and U.S. taxes on the profits of its U.S. subsidiaries. When a U.K. company receives a dividend from an "overseas" subsidiary, such as Powergen USA, the dividend is subject to U.K. corporation tax. As the dividend is paid out of profits that have been taxed in the overseas subsidiary, in order to avoid the U.K. company suffering tax twice on the same profit, the U.K. tax system gives a credit against the U.K. tax charge for the foreign tax already paid on the profits and for withholding taxes suffered on the dividend payment ("double tax relief").

Most developed countries operate some form of double tax relief system. The U.S. tax system allows credit relief for foreign taxes on foreign source income, although the mechanics of computing the relief differ from the U.K. approach. The credit given by the U.K. for the tax paid by the subsidiary on the profits out of which the dividend has been paid is "so much of the foreign (i.e., U.S. and any third country) tax borne on the relevant profits by the body corporate paying the dividend as is properly attributable to the proportion of the relevant profits represented by the dividend."(15) The "relevant profits" are the profits available for distribution

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(13) See Rule 45(c) Adopting Release ("The rule specifies the amount to be allocated, that is, the difference between the consolidated return and separate return results, and establishes the principle of allocating to the individual members of the group the material effects of any particular features of the tax law applicable to them.").

(14) See Rule 45(c) Proposing Release: "The investment tax credit, an important addition to the tax law subsequent to the adoption of [Rule 45(b) (6)], is similar in significant respects to the tax loss. It is clearly identifiable to a particular member of the group, its incidence has no necessary relationship to current income, and its use in the consolidated return precludes a carryover by the company entitled to it."

(15) U.K. Income and Corporation Taxes Act 1988, section 799(1).

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out of which the dividend has been paid and not, for example, the taxable profits of the overseas subsidiary.(16)

Consequently, if in the example shown above Subsidiary A was a single company wholly owned directly by a U.K. company, its relevant profits would be computed as follows:

<Table>
<Caption>

<S>	Subsidiary A <C>
Revenues	400
Expenses	200
Income	200
Tax (40%)	80

Relevant profits	120

</Table>

Therefore, if Subsidiary A paid a dividend equal to its relevant profits of $120, the U.K. will give a credit for the U.S. tax of $80 paid on those profits, because that is the U.S. tax borne on the relevant profits by the company. The U.K. double tax relief position would be exactly the same if Subsidiary A were a member of a consolidated tax group in which all members are profit making and paying tax.

However, when tax losses incurred by one overseas company, i.e., Powergen USA, are used by another overseas company, one of the LG&E Energy retail utilities, for example, for the purposes of calculating the overseas tax paid by that company, the amount of U.K. double tax relief available will depend upon whether the profit making company pays for the use of tax losses. The issue arises because, when a dividend is paid, the tax paid by the company paying the dividend is pro-rated in accordance with the proportion of the company's relevant profits that are distributed. A payment for tax losses reduces relevant profits of the company, thereby increasing the proportion of relevant profits that relate to the dividend.

U.K. tax relief has traditionally looked at each company separately for the tax paid, the relevant profits and the dividend. It has not looked at the companies on a combined basis. The tax paid by the consolidated group has been divided between the companies with taxable profits pro-rata to their taxable profits. The tax allocation agreement is not used to allocate tax paid; it only has an impact on the computation of relevant post-tax profits.

This can be illustrated by the following example:

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(16) Bowater Paper Corporation v. Murgatroyd, 46 TC 37 (House of Lords, 1970).

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<Table>
<Caption>

<S>	Subsidiary A <C>	Subsidiary B <C>	Holding Co. C <C>	Consolidated <C>
Revenues	400	800	200	1400
Expenses	200	300	410	910
Income	200	500	-210	490
Allocation of C's loss	60	150	210	0
Net Taxable Income	140	350	0	490
Tax (40%)	56	140	0	196

</Table>

(1) If A pays $24 (i.e., 40% of $60) to C for its losses, its relevant profits are $120 (i.e., the same as if it were a stand alone entity), calculated as follows:

<Table>
<Caption>

Subsidiary A

<S> <C>

Revenues	400
Expenses	200
Income	200
Tax paid	-56
Payment to C for loss	-24
Relevant profits	120

</Table>

Thus if A pays a dividend of $120 the dividend represents the whole of the relevant profits of A and so the tax credit attaching to the dividend is the amount of tax paid by the consolidated group allocated to A (i.e., $56).

(2) However, if A did not pay C for its loss, its relevant profits would be $144 (i.e., income of $200 less tax paid allocated to A of $56). Therefore, if A paid a dividend of $120 the proportion of the relevant profits represented by the dividend is 120/144 of the relevant profits of A. Consequently, the tax credit attaching to the dividend is only $47, 120/144 of the tax paid by the consolidated group allocated to A, and not the full $56.

This is not reversed when C returns to profitability.

Although UK companies tend to own overseas subsidiaries through one or more intermediate wholly-owned holding companies resident in an EU state this does not affect the analysis above.

Recent changes in U.K. tax legislation would in normal circumstances now allow U.K. tax relief for foreign taxes to be determined on a consolidated basis where a number of companies located in the same territory file a consolidated tax return. However, it is unclear whether this legislation will apply when the parent company of that consolidated territorial group (i.e., Powergen USA in this instance) is not a company. Although Powergen USA has elected to be treated for U.S. tax purposes as a company, it is for all other purposes (including U.K. tax) a general partnership.

Clarification of whether U.K. tax relief can be computed on a consolidated basis in such circumstances under the new legislation will in all likelihood not be obtained until a claim for foreign tax relief is submitted in respect of a dividend paid by a consolidated group headed by a

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partnership. The issue will then be considered by (and possibly debated at some length with) the U.K. tax authorities. Obtaining clarification may therefore take at least two to three years.

WHY POWERGEN HAS A POLICY FOR PAYMENT FOR TAX LOSSES

The U.K. does not have a system of consolidated tax returns. Each company is taxed as a separate entity. If a U.K. company ("the surrendering company") incurs a loss it may "surrender" that loss to another U.K. company in the same group which has profits (the "claimant company"), thereby reducing the taxable profits and hence tax liability of the claimant company. This is known as "group relief" and is available where the companies are at least 75% owned by a common

U.K. parent company.

The U.K. tax legislation specifically provides that a claimant company may pay the surrendering company for the losses surrendered and that such payments are ignored for U.K. tax purposes (i.e., they are neither tax deductible nor taxable), provided that the payment does not exceed the amount of the loss.(17)

In many cases payment for losses must be made by a claimant company, otherwise the surrender of the losses is unlawful and is void. This is because the losses are seen as an "asset" of the surrendering company and in many cases a company cannot dispose of an asset for less than its value. This principle can apply, for purposes of creditor protection, even within a group of wholly owned companies. Furthermore, the surrender of losses without payment could, in certain circumstances, amount to unlawful "financial assistance" for the acquisition of a company's shares; a criminal offense.

For these reasons, Powergen has a group policy requiring payments by group companies whose tax liability is reduced due to transfers of tax losses from other group companies. Powergen's intention is that such policy be applied to all companies within the group, including U.S. companies.

WHY POWERGEN WILL SUFFER AN INCREASED LUXEMBOURG TAX LIABILITY WITHOUT THE PROPOSED AGREEMENT

As described above, the Agreement provides that the tax benefits attributable to the acquisition-related debt shall be retained at LG&E Energy. If the funds comprising these benefits were paid to Powergen USA, these funds would be regarded as income of Powergen USA and, in turn, Powergen USA's parents. Powergen USA is owned jointly by Powergen Luxembourg Investments sarl and Powergen Luxembourg Holdings sarl, both of which are organized in Luxembourg. Therefore, funds paid to Powergen USA for tax benefits attributable to the acquisition-related debt would be subject to taxation in Luxembourg.

By retaining these tax benefits at LG&E Energy, the amount of these tax benefits is not taxed in Luxembourg and this represents a savings to the Powergen holding company system. This can be illustrated by example.

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(17) UK Income and Corporation Taxes Act 1988, section 402(6).

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<Table>

<S>	<C>
Amount of Acquisition-Related Debt	$3,000,000,000
Rate of Interest	7%
Annual Interest Payment	$ 210,000,000
U.S. Tax Rate	35%
Powergen USA's Tax Benefit	$ 73,500,000
Luxembourg Tax Rate	37%
Luxembourg Tax on Powergen USA's Tax Benefit	$ 27,195,000

</Table>

If the tax benefit associated with acquisition-related debt were paid to Powergen USA, using the assumptions stated above, the Powergen system would lose approximately $27 million each year to the Luxembourg tax authorities. By retaining the tax benefits at LG&E Energy, this amount is retained by the Powergen system and the total amount of the tax benefits is available to the LG&E Energy Group for its use. Therefore, and as illustrated above, without the Agreement, Powergen will suffer an increased Luxembourg tax liability.

CONCLUSION

Powergen's proposed Agreement seeks to give each associate company in the group, including Powergen USA, the opportunity to receive payment for, or assignment of, the tax losses or credits that entity generates. The Agreement will not give rise to the types of problems (e.g., upstream loans and misallocation of tax benefits) that the '35 Act was intended to address.

The subsidiary-but-not-holding-company reading of Rule 45(c) is not required by the '35 Act. The separate return limitation and other provisions of Rule 45(c) prevent the misallocation of tax benefits to the holding company or its assignee. The wholesale exclusion of holding companies from retaining their tax benefits is not only unnecessary to meet the policy objectives of the '35 Act, but unfair to holding company investors.

Under Section 12(b) and Rule 45(a), the Commission may approve a tax allocation agreement that does not comply with Rule 45(c), provided that the agreement otherwise satisfies the policies and provisions of the '35 Act.(18) Powergen's proposed Agreement complies with Rule 45(c) in all respects other than allowing Powergen USA to assign the benefit of its losses,(19) and this deviation from the rule does not create an impermissible loan, extension of credit or indemnity under Section 12.(20) In addition, the Agreement is not an impermissible allocation under Section 13, and it is not detrimental to consumers, investors or the public interest. Finally, the Commission explicitly approved a substantially similar tax allocation agreement when it authorized the merger of The National Grid Group plc and New England Electric System.(21) For

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(18) Rule 45(c) Proposing Release ("While tax agreements inconsistent with the rule may, in principle, still be applied for under Rule 45(a), such action is not expected. It would be justified only in truly unforeseen and exceptional circumstances.").

(19) As observed above it is arguable that Powergen USA should be deemed to be a subsidiary company entitled to assign its losses to LG&E Energy.

(20) In particular, because the agreement provides for current payment of corporate tax credits (i.e., the value of the tax loss or other tax benefit used on the consolidated return) to loss companies, it does not involve an impermissible loan within the meaning of Section 12(a).

(21) See Holding Co. Act Release No. 27154 (March 15, 2000).

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the reasons stated above, we believe that the Commission should approve the Agreement, as proposed.